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TAGS: AO ECON EFIN ENIV EPET PGOV
SUBJECT: GRA SLASHES BUDGET AS MACRO OUTLOOK DETERIORATES

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Classified By: Ambassador Mozena for reasons 1.4 (b) and (d).

¶1. (U) SUMMARY: Following steep declines in the oil revenues that generate much of Angola's income, the GRA will cut spending on goods and services across all ministries by 36 percent and subsidies and social transfers by 40 percent from Angola's previously approved 2009 budget. Our contacts tell us the GRA does not want to run a fiscal deficit in 2009, despite the country's considerable foreign reserves and (allegedly) robust stabilization fund. While the long term investments in infrastructure and development projects have not been cut (many, in fact, are funded by off-budget loans from China), the substantial drop in government outlays will adversely affect the many Angolans dependent upon subsidies and social transfers, as well as the non-petroleum sector. As pressure mounts on policy makers to devalue the Kwanza, a recent speculative run against the currency could indicate the GRA is close to making a decision to devalue in order to save its reserves. End Summary.

GRA Slashes Budget 35 Percent

¶2. (C) After much internal debate over whether to re-adjust the 2009 budget or finance it with Angola's reported USD 20 billion in reserves, the GRA now plans to cut the 2009 budget by 35 percent across the board. The GRA formally passed its "Anti-Crisis Plan" on February 26, which called for an undisclosed cut in government purchases of goods and services, halting new public investments, restructuring "strategic public enterprises," and competitive substitution of imports aided by "temporary protectionist measures." In discussions with Armando Manuel, Director of the National Treasury at the Ministry of Finance, EconOff learned that the GRA would cut the expenditures on goods and services by 35 percent across all ministries and cut subsidies and social transfers by 40 percent. He confirmed the government would continue to fund existing development projects due to their long-term importance to the economy and their importance to Angola's hosting of the Africa Cup in early 2010, but will not start any new ones during 2009.

3.(C) Manuel said the primary goal of the GRA was to prevent a fiscal deficit (the first since 2004), which under the original 2009 budget was projected to reach 9 percent of GDP, down from a 2008 surplus of 10 percent. When asked about using Angola's reported USD 20 billion in reserves held by the Angolan Central Bank (BNA) or the undisclosed billions in its off-shore sovereign wealth fund, he replied that the GRA viewed the global economic downturn as a "short-term shock" and felt it wiser to tighten up spending (i.e. keep long-term investment and debt service spending, but cut current expenditures).

Reserves Decline Significantly

¶4. (C) Although Angola is not spending its reserves to sustain budget expenditures, it is drawing down those reserves nevertheless. The February 27 edition of "Novo Journal" (a paper owned by Banco Espirito Santo,) reported that Angola spent one-quarter of its USD 20 billion foreign reserves over the past three months, leaving USD 15 billion in the treasury. The February 28 edition of "Economia" also ran a story on the reserves and put the recent drop at about 17 percent. GRA officials have not publicly confirmed such a large drop; however, Vice Governor of the Central Bank (BNA) Rui Minguens would not deny the report in a private conversation with the Embassy. While Angola reportedly also has a sovereign wealth fund alleged to contain at least USD 20 billion, there is no clear indication of where it is invested or what loses, if any, it has suffered during the crisis.

¶5. (C) The Angolan press also reports that the state oil company, Sonangol, which has invested billions of the nation's oil wealth abroad, suffered notable losses, including USD 3 billion in European investments alone. One investment identified was a nine percent stake in Millennium Banco Commercial Portuguese, a bank that saw its share price plummet 75 percent in the last year. (NOTE: Sonangol typically invests 50 percent of its profits in self-managed investment funds with which it has acquired assets around the world. For 2008, Post estimates that the amount could have been as much as USD 13 billion, all significantly exposed to the effects of the global financial crisis. END NOTE). Oil industry contacts recently told Emboffs that Sonangol has yet to come up with its 23 percent share of the estimated USD 6 billion for the Angola LNG terminal now under construction in Soyo, and that the parastatal is exploring the possibility with a U.K firm of raising USD 2.5 billion through a bond issuance to cover its share of the LNG terminal.

Double Whammy Will Contract Economy...

¶6. (U) The sharp drop in oil prices over the last eight months, coupled with OPEC-mandated production cuts has significantly worsened Angola's macro economic outlook for
¶2009. As late as December, the Ministry of Finance and other economists had projected that Angola, which relies on exports of petroleum for 60 percent of its GDP and 80 percent of its government revenues, would have real GDP growth of around 12 percent in 2009; cooling somewhat, but yet continuing, a five year trend of strong double-digit GDP growth. In fact, the GRA had confidently based, and passed, its 2009 budget on a reference price for Brent of $55 per barrel last fall (see reftel). However, since then, and with the steep drop in petroleum prices, OPEC agreed to two production cuts including a 13 percent reduction (244 thousand barrels per day) for Angola.

¶7. (U) As a result of these changes, the World Bank is now estimating that Angola could have a nominal GDP contraction of 17 percent (assuming an oil price of USD 50 per barrel), with 2009 inflation estimated at 10 percent. One noted Angolan economist predicts an 11 percent negative nominal GDP growth rate driven by an estimated 30 percent growth in the agricultural sector. For perspective, the much smaller size of the entire non-petroleum economy, relative to the oil sector, would have to grow by 22 percent in 2009 just to offset the 13 percent decrease in oil production (at $55 per barrel) in order to end up with a flat GDP at zero percent growth rate. The GRA currently predicts a 16 percent growth rate for the non-petroleum sector. In a worst case scenario where oil averages at $40 per barrel for 2009 and the OPEC cuts are maintained throughout, total revenues could decline by as much as 50 percent in 2009, bringing the nominal decline in GDP to almost 23 percent.

...Yet Provide No Relief on Inflation

¶8. (U) The large decrease in the in-flows of foreign exchange and the drop off in demand of goods and services by the GRA are not expected to bring relief for inflation, now at 13 percent. The GRA will likely continue to spend hundreds of millions of dollars from off-budget Chinese lines of credit on development projects, including airport and stadium projects to host the 2010 Africa's Cup, effectively negating the spending cuts from the 2009 budget. Additionally Angola still has formidable supply constraints and infrastructure bottlenecks that will not change significantly in 2009, which also contribute to inflation. For 2009, the GRA has again set its target inflation rate at 10 percent. (COMMENT: Although Angola has done an impressive job bringing its high inflation under control since the war ended in 2002, the reality here is that even a stable 10 percent inflation rate will be tough on the average Angolan in the face of a contracting economy. END COMMENT)

Is the Kwanza Overvalued?

¶9. (C) The Kwanza, which has been pegged to the dollar at 75 to one since 2005, is overvalued and appears to have been under speculative attack. In a February 14 "Journal de Angola" article, Vice Governor Minguens disclosed that the BNA had recently encountered a spike in the demand for dollars at USD 335 million in one day, where it had been averaging USD 50 to 60 million per day. Angola is now experiencing a large decrease in the rate of forex flow into the country due to a large drop in the price and quantity of its principal export. This phenomenon can dramatically affect the real exchange rate of a country. This fact, coupled with the speculative attack alluded to by the Vice Governor of the BNA, and the dramatic drop in reserves over the last three months suggest that the Kwanza needs to be devalued. A February 28 article in "Economia" chastises the BNA for refusing to devalue and puts the real value of the Kwanza at 85 to one USD, while noting that many petroleum economies already have devalued, citing Nigeria, Russia, and Kazakhstan. On February 26, Bloomberg quoted Michael Hugman, emerging market analyst for Standard Bank, as putting the odds of a devaluation in the next six months at 50 percent. (COMMENT: The risk here is that Angola may commit its considerable reserves to defending the overvalued Kwanza and then face a forced devaluation after transferring its foreign reserves to speculators. The GRA would then be in a weaker position than otherwise coming out of what is clearly going to be a recession in 2009. END COMMENT)

COMMENT

¶10. (C) While the sky is not falling in Angola, clearly it is in for a difficult year with a projected negative GDP growth of 17 percent, the first negative growth since 1995. Angola officially has the reserves to weather the $100 dollar drop in oil prices and help maintain the standard of living for Angolans, but for unknown reasons it is disinclined to use them. The GRA decision to cut the budget instead of spending some reserves for what it views as only a "short-term shock" is too fiscally conservative and exactly the opposite thing to do for a country with huge social spending needs. The apparent loss of reserves to speculators nullifies the GRA's stated effort of saving its reserves by cutting government expenditures. By devaluing, it could keep Kwanza expenditures up (and social spending up) while saving the reserves for necessary imports. Whether the GRA is worried about the effects of a devaluation on inflation, or desires to keep much needed foreign inputs cheap, continuing to defend an overvalued Kwanza will effectively transfer the nation's wealth to a small slice of the population (the elite importers and would-be speculators) at the expense of social development. Similarly, the GRA's economic diversification

effort will be hampered by the cut in government spending. Angola has chosen to maintain spending on development projects, including the ones needed for the Africa Cup in 2010, through the use of off-budget lines of credit from China. However, this will not help ease inflation during this downturn, and it does little for employment since many of these Chinese-funded projects use Chinese labor.

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